Office of Chief Counsel
Internal Revenue Service

memorandum

CC:WR:RMD:DEN:TL-N-5683-99
WPBoulet

date: FEB 18 2000

to: Chief, Examination Division, Rocky Mountain District
Attn: Shirley Beukelman, Team Coordinator

from: District Counsel, Rocky Mountain District, Denver

subject: [redacted]
Specified Liability Losses Under I.R.C. Sec. 172(f)
Tax years: Calendar years [redacted] and [redacted]

This memorandum is in response to your request for advice concerning whether specified liability losses eligible for a special 10-year net operating loss carryback have been properly claimed by [redacted] for its [redacted] and [redacted] tax years.

Generally speaking, I.R.C. §172(f) provides that net operating losses ("NOLs") may be carried back ten years to the extent the NOLs are attributable to specified liability losses("SLLs"). During the tax years involved, SLLs under the statute included product liability losses and expenses associated with the investigation, settlement or opposition to product liability claims. Additionally, tort liabilities, as well as liabilities arising out of a Federal or State law, were treated as SLLs in certain circumstances. In the case of a tort liability, it qualifies as a SLL only if it "arises out of a series of actions (or failures to act) over an extended period of time a substantial portion of which occurs at least 3 years" prior to the taxable year in which the deduction is reported. For liabilities arising out of a Federal or State law, "the act or failure to act giving rise to such liability" must have occurred "at least 3 years before the beginning of the taxable year" in which the deduction is reported. A more detailed explanation of §172(f) is given below.

BACKGROUND

[redacted] has claimed that $[redacted] of its consolidated [redacted] NOL, and $[redacted] of its consolidated [redacted] NOL constitute SLLs which may be carried back as much as ten years, generating substantial refunds in the carryback years.

These claimed SLLs generally fit into the following categories:

I. Tax-related costs - These costs are comprised of
   (a) Tax department costs incurred in complying with federal and state tax laws.
   (b) Sales and use tax audit settlements, including back-interest and deficiencies.

II. Workers' compensation - The costs involved include:
   (a) Self-insurance payments made for injuries occurring prior to [redacted], and
   (b) Premiums paid to various state workman's compensation funds or to state-endorsed monopolistic funds.

III. Tort and/or product liabilities - Costs associated with the payment of claims, allegedly for torts. Based on the facts you provided to us, it is possible that some of the lawsuits involved claims with multiple theories of recovery, including tort, contract and product liability claims. The types of claims include:
   (a) Employment discrimination.
   (b) Negligence/Fraud.
   (c) [redacted] claims.
   (d) Shareholder suits, alleging deceptive accounting practices and misuse of company assets.
   (e) [redacted] cases, with the causal events having occurred before [redacted].

III. Environmental costs, which are associated primarily with [redacted]'s mining and oil exploration activities, and involve contamination acts or series of acts occurring before [redacted].

IV. Settlement losses attendant to the shareholder suits, involving (1) the placement of [redacted] stock warrants into a settlement trust, and (2) the payment of cash into the trust by [redacted]'s insurers.

Each of the above-listed categories of expenses are analyzed below. Additional details that are important to the analysis are included together with the discussion of each category for ease of reference.

DISCUSSION

I. The Law -

A. Statute and Regulations -

Section 172(f), as in effect for the years in issue, provides in pertinent part, as follows:

> (f) RULES RELATING TO SPECIFIED LIABILITY LOSS.- For purposes of this section -
>
> (1) IN GENERAL - The term "specified liability loss" means the sum of the following amounts to the extent taken into account in computing the net operating loss for the taxable year:
>
> (A) Any amount allowable as a deduction under section 162 or 165 which is attributable to -
>
> (i) product liability, or
>
> (ii) expenses incurred in the investigation or settlement of, or opposition to, claims against the taxpayer on account of product liability.
>
> (B) Any amount (not described in subparagraph (A)) allowable as a deduction under this chapter with respect to a liability which arises under a Federal or State law or out of any tort of the taxpayer if -
>
> (i) in the case of a liability arising out of a Federal or State law, the act (or failure to act) giving rise to such liability occurs at least 3 years before the beginning of the taxable year, or
>
> (ii) in the case of a liability arising out of a tort, such liability arises out of a series of actions (or failures to act) over an extended period of time a substantial portion of which occurs at least 3 years before the beginning of the taxable year.
>
> A liability shall not be taken into account under subparagraph (B) unless the taxpayer used an accrual method of accounting throughout the period or periods during which the acts or failures to act giving rise to such liability occurred.
>
> ****
>
> (4) PRODUCT LIABILITY - The term "product liability" means -
>
> (A) liability of the taxpayer for damages on account of physical injury or emotional harm to individuals, or damage to or loss of the use of property, on account of any defect in any product which is manufactured, leased, or sold by the taxpayer, but only if
>
> (B) such injury, harm, or damage arises after the taxpayer has completed or terminated operations with respect to, and has relinquished possession of, such product.

Regulations promulgated with respect to sec. 172(f) exist only with respect to product liability losses. See Treas. Reg. §1.172-13. Among other things, the regulations provide that the term "product liability" does not include liabilities arising under warranty theories relating to replacement or repair of the product. §1.172-13(b)(2)(ii). Additionally, the regulations provide that liability incurred as a result of services performed by a taxpayer is not product liability. Id. Nevertheless, where both a product and services are integral parts of a transaction, liability that arises after the initial delivery, installation, servicing, testing, etc., is considered product liability, including liability arising out of subsequent servicing of the product. Id.

The regulations further provide that an insurance premium paid with respect to product liability is not considered paid on account of "product liability" within the meaning of the statute. §1.172-13(b)(2)(iv). Nevertheless, nonrefundable amounts paid to an insurer with respect to a specific claim, if they otherwise qualify under the statute and regulations, are considered to have been paid on account of "product liability." §1.172-13(b)(2)(v).

Finally, we note that the regulations define deductions attributable to product liability to include only expenses directly attributable to product liability, or the expenses (including settlement payments) incurred in connection with the investigation or settlement of, or opposition to, claims against the taxpayer on account of alleged product liability. §1.172-13(b)(1). Indirect corporate expense, or overhead, is not to be included in a product liability loss for purposes of the statute. Id.

B. Case law -

(b)(7)a [redacted]

Perhaps the most significant of the cases decided thus far is that of Sealy Corp. and Subsidiaries v. Commissioner, 107 T.C. 177(1996), aff'd 171 F.3d 655 (9^{th} Cir. 1999). In Sealy, the taxpayer claimed SLLs for fees paid to its lawyers and accountants with respect to regulatory compliance work (tax, ERISA and SEC work) performed during the tax years in issue. Sealy contended that the liabilities were incurred because it was required to comply with the Federal laws involved. It also asserted that the events which required such compliance occurred more than 3 years prior to the years in issue, dating back to the time when the corporation was organized or otherwise became subject to such Federal laws.

The Tax Court held for the government in Sealy, and the 9th Circuit affirmed the decision on appeal. The Tax Court based its decision on the fact that Sealy's liability to pay for the professional services arose contractually, at the time Sealy chose to receive the services, not under Federal law. Thus, the Tax Court found that the liabilities in question did not meet the requirements of §172(f)(1)(B) of arising under federal law or of occurring at least three years before the beginning of the taxable year. The Tax Court also held that the routine costs of regulatory compliance were not of the same general type of expenses specifically mentioned in §172(f), i.e. product liability expenses, tort losses and nuclear decommissioning costs, and thus could not be considered to come within the intended scope of the statute. Nor were these professional expenses subject to the economic performance rules of §461(h)(2)(A)(i). The Tax Court considered this fact significant in light of the legislative history behind sec. 172(f), which was enacted to provide relief from some of the harsh effects of the contemporaneously enacted economic performance rules. Under this interpretation, Congress only intended to provide relief for those taxpayers whose deductions are deferred because of the economic performance requirements for at least the three year prescribed period.

In affirming Sealy, the 9th Circuit held that the professional fees at issue did not arise under federal law and that the 3-year (act or failure to act) rule was not met. Having so held, the appeals court stated that it did not find it necessary to consider the Tax Court's rationale concerning the economic performance rules of §461(h). The 9th Circuit also did not express its views concerning whether the types of losses for SLL status are limited in scope to losses similar in nature to the ones enumerated in the statute.

In Intermet Corp. v. Commissioner, 111 T.C. 294 (1998), it was held that a consolidated group member having SLL deductions under section 172(f), but net positive separate taxable income under Treas. Reg. §1.1502-12, contributes no amount of SLL deductions to the group's consolidated NOL. Thus, no amount of that member's SLLs are available for 10-year loss carryback to any prior years of either that member or the group. Id.

One bankruptcy case is worthy of mention. In United States v. Balsam Corp., 232 B.R. 160 (E.D.Mo. 1997), the District Court affirmed the Bankruptcy Court's finding that a fraudulent scheme involving misrepresentation of corporate earnings over a six year period prior to the tax year in issue, resulting in losses from the settlement of shareholder lawsuits, gave rise to tort liabilities constituting SLLs under sec. 172(f).

C. Rulings -

Chief Counsel's National Office has issued a number of Private Letter Rulings interpreting §172(f). Pursuant to §6110(j)(3), these rulings are not precedential and cannot be used or cited as such. However, review of these rulings can provide insight useful in analyzing the extent to which §172(f) applies in a given situation. Nevertheless, we must recognize that such rulings merely reflect the thinking of Chief Counsel at the time they were issued. They do not even carry the force of a Revenue Ruling, which the Service is committed to follow in similar factual circumstances.

Based in part upon a portion of the Tax Court's analysis in the Sealy case, it is our position that §172(f) is intended by Congress to apply only to a narrow class of liabilities, where the deductibility of an item is inherently delayed by the nature of the item, resulting in a substantial delay between the time the act giving rise to the liability occurs and the time a deduction may be claimed for the liability. In PLR 9840003 (May 29, 1998), it was stated that "a Federal income tax liability or related State income tax liability, and any interest thereon, does not constitute an inherent delay liability, and does not arise under a Federal or State law within the meaning of §172(f)(1)(B)." See also PLR 199922046 (March 5, 1999)("...a state tax liability constitutes a routine cost that does not involve an inherent delay between the time the events giving rise to the liability occur and when the deduction for such liability becomes allowable.") The fact that delays actually occur because a tax is unsuccessfully contested, does not amount to a delay which is inherent in the nature of the liability since a taxpayer need not underpay its state tax liability. Id.

As for the language in §172(f)(1)(B) which refers to deductions "with respect to" a liability arising under Federal or State law, it is our position that such language should be interpreted narrowly. Additionally, although a chain of causation might be said to give rise to liabilities under Federal or State law, it is the final act or failure to act in the chain of causation leading to the creation of a given liability from which it can be determined that the taxpayer has a legal obligation which would qualify as "the act or failure to act" within the meaning of the statute. See PLR 199944004 (Nov. 5, 1999).

Additional PLRs are referenced below as appropriate to the analysis of the specific types of SLLs claimed by [redacted].

II. Analysis -

A. Tax-related Costs -

Based on the Sealy case, discussed above, we conclude that none of the compliance costs, deficiencies or interest paid would qualify as a specified liability loss under §172(f).

B. Workers' compensation -

(b)(5)(DP), (b)(7)a [redacted]. We do note, however, that the accrual and deduction of certain workers' compensation payments was the subject of controversy prior to the enactment of the economic performance provisions of §461(h). The regulations under that provision specifically cover workers' compensation payments. Treas. Reg. §1.461-4(g)(2). We further note that certain payments made pursuant to workers' compensation laws may be delayed for a period more than 3 years after the injury giving rise to the liability has occurred. Such payments (for years 4 and forward) would, therefore, appear to fit within the scheme of relief which Congress sought to establish through enactment of §172(f).

On the other hand, payments which are delayed solely because of a controversy over whether they are owed, appear not qualify under the 3-year rule. Thus, payments for years 1 through 3 after the injury occurs, which are delayed until the controversy over the workers' compensation claim is resolved, are not "inherently delayed," and would not qualify as SLLs. Rather, any delay beyond 3 years pertaining to such payments is the result of the controversy, not the inherent nature of the liability.

With respect to workers' compensation insurance premiums, the deductibility of such payments is not subject to "inherent delay." They are routine costs, deductible when incurred, not like those costs identified in the statute. See Sealy, 107 T.C. at 186.

(b)(5)(DP), (b)(7)a [redacted]

(b)(5)(DP), (b)(7)a [redacted]

C. Tort and/or product liabilities -

Section 172(f) permits a 10-year carryback for deductible payments which are "attributable to" product liability (and certain associated expenses) or "with respect to" a tort of the taxpayer. Important consequences flow from whether the claimed deduction is associated with a product liability, a tort, or neither. For example, costs incurred in connection with the investigation, settlement or opposition to a product liability claim are eligible SLLs. In contrast, such costs are not part of the SLL if they are incurred in connection with a tort. Another key difference is that only multiple act torts qualify for SLL treatment, with the additional requirement that a "substantial portion" of the acts giving rise to the liability must have occurred more than 3 years prior to the tax year of the deduction. It is also important to note that deductions associated with contractual liabilities are not within the ambit of section 172(f).

(b)(7)a [redacted]

When multiple claims are settled, the allocation of the total consideration paid among the claims settled is a question of fact. We know of no cases determining such an allocation in the context of section 172(f). In other circumstances, for example in the context of sec. 104(a)(2), the determinative inquiry is "the intent of the payor as to the purpose in making the payment." <u>Stocks v. Commissioner</u>, 98 T.C. 1, 10 (1992)(citing <u>Knuckles v. Commissioner</u>, 349 F.2d 610, 612 (10th

Cir. 1965). (b)(7)a [redacted]

When allocation of the payment is found in the settlement agreement, it is usually considered conclusive and, therefore, controlling, but only if the agreement was "negotiated at arms length between adverse parties." McKay v. Commissioner, 102 T.C. 465, 482-483 (1994). However, if the allocations are "uncontested, nonadversarial, and completely tax motivated," they will be rejected. See e.g. Robinson v. Commissioner, 102 T.C. 116, 134 (1994).

Another important consideration is whether the particular categories of lawsuits and claims [redacted] has identified might be classified as involving torts, product liabilities, or other types of liabilities. There is no clear answer to this inquiry, because the classification of a claim as a tort, for example, is not clear cut. Nor is it necessarily easy to determine from [redacted]'s classifications whether any of the claims within a particular class might be single-act or multiple act torts. For instance, the [redacted] Claims category identified by [redacted] may, in a particular case, be either a tort claim or a product liability claim, and it might also involve a single act or multiple acts giving rise to that liability.

Whether a personal injury claim for an [redacted] injury is a tort or a product liability claim depends upon the facts of the case and the law of the jurisdiction in which the claim is brought. Whether a particular [redacted] liability claim involves a single act or multiple acts might depend on the nature of the disease, e.g. [redacted] (which typically is caused by repeated exposure) or mesothelioma (which can be caused by a single exposure).

Similarly, the employment discrimination liabilities identified by [redacted] are not necessarily torts, and it is not clear whether in a particular case the liability arose from a single act or multiple acts. The Supreme Court has determined that a claim is tort-like only if it provides broad remedies consistent with "traditional tort liability." United States v. Burke, 504 U.S. 229, 237 (1992). In Burke, the Supreme Court decided, in the context of sec. 104(a)(2), that sex discrimination under

Title VII of the Civil Rights Act of 1964, which prohibits discrimination in employment on the basis of race, sex, religion and national origin, is not tort-like because Title VII, prior to its amendment in 1991, limited remedies to back pay. Id. at 238. According to Burke, traditional tort liability includes damages for lost wages, medical expenses, diminished future earning capacity, emotional distress, pain and suffering, impairment of reputation and standing in the community, personal humiliation, mental anguish and suffering, and where the defendant's misconduct was intentional or reckless, punitive or exemplary damages. Id. at 235-237. More recently, in Commissioner v. Schlier, 115 S.Ct. 2159 (1995), the Supreme Court held that a claim arising under the Age Discrimination and Employment Act (the "ADEA") was not a tort, applying the test it had formulated in Burke. The available damages under the ADEA incorporated the remedial provisions found in the Fair Labor Standards Act, which effectively limits the damages to back pay and, if the violation is willful, liquidated damages equal to back pay.

Since "employment discrimination" claims can encompass a broad range of claims under various State and Federal laws, it is not possible here to give you a complete analysis of the numerous scenarios likely to be embedded in [redacted]'s assertion that its liabilities constitute SLLs. The above explanation is only a brief introduction to some of the complexities inherent in determining whether such employment discrimination claims constitute torts. (b)(5)(AC), (b)(7)a [redacted]

In addition to the above-mentioned categories of suits ([redacted] and employment discrimination), the taxpayer has also asserted SLL treatment with respect to [redacted] claims, shareholder suits and suits involving negligence/fraud. Like the other categories, each claim in these last three categories must be carefully analyzed.

Negligence and fraud allegations are closely associated with traditional, common law torts. If the 3-year and multiple-act requirements of sec. 172(f) are met, liabilities arising from negligent or fraudulent acts of the taxpayer would most likely qualify for the 10-year carryback. However, we must caution you to carefully review the complaint filed in the lawsuits which [redacted] alleges are qualified as SLLs. Although allegations of negligence and fraud are associated with certain common law torts, they are also frequently raised in connection with contract disputes or where statutorily granted rights are at stake, such as shareholder lawsuits. Contract liability disputes clearly do not qualify for SLL treatment.

The shareholder lawsuits brought against [redacted] do possibly involve "torts." See United States v. Balsam Corp., 232 B.R. 160 (E.D.Mo. 1997). (b)(5)(AC), (b)(7)a [redacted]

Below, we address the additional issues related to settlement of the shareholder lawsuits: (1) whether such liabilities arise under federal or state law within the meaning of sec. 172(f); (2) whether [redacted] is entitled to a deduction in [redacted] for its contribution of stock warrants to the settlement fund created to resolve its shareholder lawsuits; and (3) whether [redacted] is entitled to a deduction, to be included as part of its SLL, for the liability paid by its insurers when they paid $[redacted] cash into the settlement fund.

(b)(5)(AC) [redacted]. Liability for fines and corrective actions pursuant to [redacted] laws would clearly not constitute a tort. Nor would the deduction of such liabilities involve any "inherent delay" between the time the legal obligation arises and the time [redacted] completes its enforcement action. See Sealy Corp. and Subsidiaries v. Commissioner, 107 T.C. 177(1996), aff'd 171 F.3d 655 (9th Cir. 1999); PLR 199927012 (April 6, 1999); PLR 9840003 (May 29, 1998).

We do note, however, that certain tort or product liability lawsuits may involve alleged violations of [redacted] offered as proof of the defendant's negligence. For example, if [redacted] failed to [redacted] negligently breached its duty of care to the plaintiff. It is also possible that breach of contract lawsuits, e.g. with a subcontractor, might involve defenses to the alleged breach based upon [redacted] committed by the other party to the contract. (b)(5)(AC), (b)(7)a [redacted] (b)(5)(AC), (b)(7)a

[redacted]

D. Environmental claims -

Various "environmental" claims have been asserted by [redacted] to be part of its SLLs for the years in issue. At this point, we know very little about the nature of these claims, other than [redacted]'s claim that the liabilities arise from acts (or series of acts) of contamination prior to [redacted]. It is not possible to give you an opinion concerning the validity of [redacted]'s assertions until we have specific knowledge of the environmental claims which gave rise to each of these liabilities. In deciding what evidence to gather, please refer to our analysis, above, concerning tort and product liability, inherent delay, the 3-year rule, liabilities under federal/state laws, and [redacted] liabilities. We stand ready to provide you with any additional assistance you require on this issue.

E. Settlement of shareholder lawsuits -

We have already shared with you our preliminary observations, above, concerning whether the shareholder lawsuits gave rise to tort liability. Additional issues related to [redacted]'s settlement of the shareholder lawsuits include: (1) whether such liabilities arise under federal or state law within the meaning of sec. 172(f); (2) whether [redacted] is entitled to a deduction in [redacted] for its contribution of "certificates" in [redacted] or for its contribution of stock warrants in [redacted] to the settlement fund created to resolve its shareholder lawsuits; and (3) whether [redacted] is entitled to a deduction, to be included as part of its SLL, for the liability paid by its insurers when they paid $[redacted] cash into the settlement fund. Issues (2) and (3) are important in the context of sec. 172(f), because it allows the 10 year carryback only with respect to amounts "allowable as a deduction" under Chapter 1 (related to income taxes) of the Internal Revenue Code. I.R.C. §172(f)(1)(B).

With respect to the first issue, it is our opinion that [redacted]'s liabilities related to shareholder lawsuits do not arise under federal or state law within the meaning of sec. 172(f). Although the liabilities may have arisen because of violations of federal and state securities laws, they relate to what are essentially private rights of action created by federal and state statutes. See e.g. Sec. 12(2) of the 1933 Securities Act (15 U.S.C. §77a et seq); Rule 10-b of the 1934 Securities Exchange Act (15 U.S.C. §78a et seq). To read sec. 172(f) more broadly would result in any private right of action cognizable at law or in equity being considered as a liability arising under federal or state law. Such a reading of sec. 172(f) is clearly beyond the narrow class of liabilities for which Congress intended to provide relief. See Sealy Corp. and Subsidiaries v. Commissioner, 107 T.C. 177(1996).[1]

Nevertheless, even if [redacted]'s shareholder suits could be considered to have arisen under federal or state law, the liabilities related to such lawsuits do not meet the "inherent delay" standard set forth in Sealy. In Sealy, costs of complying with securities laws were found not to be within the scope of sec. 172(f), in part, because they were not subject to an inherent delay between the time the liabilities arose and the time payment was required. Rather, the compliance costs were found to be routine costs payable and deductible in the ordinary course of business. Id. In our opinion, the liabilities associated with violating those same laws should not be treated any differently. [redacted] need not have violated securities laws. Its obligation to pay with respect to such violations was not inherently delayed, but was delayed merely by the time it took for those violations to be discovered and contested. Delays due solely to having contested a liability cannot be considered inherent delays related to the nature of the liability. See PLR 199922046 (March 5, 1999). This delay is unlike that associated with laws intended to be within the scope of sec. 172(f), such as mine reclamation liabilities, which are inherently delayed from the time the liability arises (disturbance of the land) to the time the obligation to pay ripens under the reclamation statute (usually, closure of the relevant part of the mine). See PLR 199927012 (April 6, 1999)(discussion of the legislative history).

As to the second issue, we preliminarily conclude that [redacted]'s payment of contingent "certificates" and, later, stock warrants into the stock fund is not deductible until such time the stock warrants are exercised, if ever. This conclusion depends upon the reliability of information you have conveyed to us, pending a complete response by the taxpayer to your IDR on this issue. Based upon the information you have provided thus far, we are assuming that the "certificates" and stock warrants were placed

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[1] But see PLR 9550011 (September 13, 1995)(holding that liabilities in connection with a shareholder suit pursuant to the Securities and Exchange Act of 1934 "arose out of Federal law" for purposes of sec. 172(f)). As mentioned above, this private ruling is not precedential. We also note that this PLR was issued more than a year prior to the Tax Court's decision in Sealy, and it possibly no longer reflects the current thinking of Chief Counsel on this issue.

into a "qualified settlement fund" within the meaning of sec. 468B. You have indicated that [redacted] agreed to transfer stock to the fund in [redacted]. At that time, [redacted] transferred "certificates" which could be converted into [redacted] shares of stock once final court approval of settlements concerning all related litigation was obtained. However, the "certificates" were to be returned to [redacted] and canceled in the event that such approval did not occur or in the event [redacted] went into bankruptcy. According to your memorandum to us, final court approval occurred sometime between [redacted] and [redacted] of [redacted]. You also have indicated that actual shares of stock were never issued pursuant to the "certificates." Instead, [redacted] went into bankruptcy, and in [redacted] it placed stock warrants into the settlement fund in satisfaction of the shareholder lawsuits. (b)(7)a [redacted]

Without sec. 468B, a deduction would not be allowed until after economic performance had occurred, which would not occur until payment had been made to the plaintiffs, rather than to the fund. However, pursuant to the regulations under sec. 468B, when the transferor transfers property to the fund, economic performance is generally deemed to have occurred and the transferor is entitled to a deduction for the transfer at such time. Treas. Reg. §1.468B-3(c)(1). One exception to this general rule is that the transfer of an obligation to transfer property in the future does not constitute economic performance until that property is actually transferred. Treas. Reg. §1.468B-3(c)(3). Stock warrants are an obligation to transfer stock in the future at a fixed price. (b)(7)a [redacted]. Pursuant to the regulation, the deduction that [redacted] claimed in [redacted], at the time it agreed (in the form of the "certificates") to issue stock, is premature. Id. Likewise, (b)(7)a [redacted]

The third sub-issue related to the shareholder settlement fund is whether [redacted] is entitled to a deduction for a $[redacted] payment made on its behalf by its insurers. We conclude that [redacted] is not entitled to a deduction for this amount which might then be counted as part of its SLL. As noted above, without sec. 468B, the economic performance rules under sec. 461(h) would preclude any deduction into a settlement fund until actual payments are made to the plaintiff(s). Section 468B permits the deduction of qualified payments into a qualified settlement fund by deeming that economic performance occurs at such time. The regulations state, however, that no deduction is allowed to the extent that the transferred amounts represent amounts received from the settlement of an insurance claim and are excludable from gross income. Treas. Reg. §1.468B-3(d). The regulation further states that, in the event a transfer to the fund has occurred for which the taxpayer took a deduction, any later insurance recovery must be taken into income to the extent of the prior deduction. Id. In this instance, [redacted] never made a payment into the fund for which it was later reimbursed by its insurers. Rather, the insurers made payments directly into the settlement fund. Accordingly, we conclude that the payment by insurers in this case does not result in either income or a deduction for [redacted]. Id.; see PLR 9507035 (November 21, 1994)(taxpayer was permitted a deduction only for the amount it contributed to a Global Settlement Trust, not for amounts paid by the insurer); PLR 9609041 (December 4, 1995)(taxpayer was not entitled to any deduction, nor required to report any income, in connection with a Trilateral Settlement Trust funded solely by its insurer).

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If you have any questions concerning this matter, please feel free to call me at (303) 844-3258, ext. 268.

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